

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 151

June 24, 1958

INTEREST INCOME: SECURITIES OF A CORPORATION WHOLLY OWNED BY A MUNICIPAL CORPORATION

Syllabus:

Debentures issued by a corporation whose stock is wholly owned by a municipal corporation are not "bonds" nor are they issued by a municipal corporation under the interpretation given to Section XIII, Section 1-3/4 of the California Constitution. Therefore, interest income received from such debentures is taxable under the Personal Income Tax Law.

Taxpayer owns debentures issued by X Corporation, a general corporation of this State. All of the stock of the corporation is in a voting trust for City A, a municipal corporation, of this State. There is no fixed date of redemption, however, the debentures may be redeemed at the option of X Corporation on any given interest date. Advice is requested whether interest received from the debentures is exempt from tax under the Personal Income Tax Law.

The Personal Income Tax Law neither expressly or impliedly exempts from tax, income from securities issued by the State or its subdivisions. Attorney General's Opinion, NS-841, March 18, 1938 and NS-2033, February 2, 1940, held the exemption in Section 1-3/4 of Article XIII of the California Constitution extends to personal income tax on interest from bonds includible in that section. Attorney General's Opinion 53-169, January 28, 1954 held that interest bearing warrants of improvement districts, if made payable at a date certain and were sold to finance improvement district projects are "bonds" within the meaning of Article XIII, Section 1-3/4. Since the debentures have no fixed redemption date they are not "bonds" under this section.

The municipal corporation is not obligated to pay for or to redeem the securities. The indebtedness is that of X Corporation and not City A. The common question in determining whether or not securities are those of a municipality is whether it has so avoided the elements of a common debtor-creditor relationship that it can no longer be said that the security is the obligation of the municipality. Since City A has no obligation to pay for or redeem the debentures, they are not securities issued by the city. Therefore, since the debentures are not "bonds" nor are they issued by a municipal corporation, the interest income received by the taxpayer is subject to taxation under the Personal Income Tax Law.